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Suasana Indah Sdn Bhd (a members' voluntary liquidation) v Ketua Pengarah Hasil Dalam Negeri

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COURT OF APPEAL (PUTRAJAYA) — CIVIL APPEAL NO W–01–102 OF 1998

MOKHTAR SIDIN, ABDUL AZIZ MOHAMAD JJCA.AND RAUS SHARIF J

9 DECEMBER 2005

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Revenue Law — Income tax — Capital versus income — Compensation for withdrawal from joint venture project — Whether was capital withdrawn from a partnership constituted by the joint venture upon its dissolution or compensation for the loss of all rights under joint venture and therefore not chargeable to tax — Proof of partnership — Tests to be applicable — Income Tax Act 1967 ss 2, 22(2)(b) & 24(1)(b)

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By a joint venture agreement dated 4 September 1990 ('the JVA'), the appellants entered into a joint venture with SPSSB to carry out a development project. Owing to disagreements between the parties, the JVA was cancelled by a letter dated 28 December 1992 from SPSSB to the appellants. On 29 December 1992, SPSSB paid the appellants RM6,400,000 as compensation to terminate the JVA. SPSSB also

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paid the appellants a sum of RM2,100,000 as reimbursement of expenses and outgoings incurred in connection with the project. By notice of assessment dated 24 September 1994 for year of assessment 1994, the respondent notified the appellants of tax assessed in the sum of RM2,048,000 on that amount. Before the Special Commissioners of Income Tax, the appellants contended that the sum of

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RM6,400,000 was either capital withdrawn from the partnership constituted by the JVA upon its dissolution or compensation for the loss of all rights under the JVA, and therefore was not chargeable to tax. The Special Commissioners found that the sum RM6,400,000 was neither capital withdrawn nor compensation for loss of all rights under the JVA but was either payment for services rendered under s 24(1)(b) of the Income Tax Act 1967 ('the Act') or compensation for loss of income under s 22(2)(b)

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and was therefore chargeable to tax. The Special Commissioners also found that no partnership existed between the appellants and SPSSB and that even if a partnership did exist the payment of RM6,400,000 could not amount to withdrawal of capital because neither party had put in capital in any form into their joint enterprise. The Special Commissioners found that no partnership existed because by art 11.7 of the

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JVA the parties agreed that they were not a partnership. The Special Commissioners dismissed the appellants' appeal and confirmed the respondent's assessment. The High Court dismissed the appellants' further appeal. The appellants appealed to this court.

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Held, dismissing the appeal with costs:

(1) The definition of 'partnership' in s 2 of the Act is not applicable for determining at large whether an arrangement between parties is a partnership. For that one must turn to the law of partnership which the appellants are not

relying on. The definition of 'partnership' in the Act is intended only for the interpretation of that word where it is used in the Act. In contending that because the sum of RM6,400,000 was capital withdrawn upon the dissolution of a partnership it was not chargeable to tax, the appellants are not relying on any provision of the Act, let alone a provision in which the word 'partnership' occurred. The contention therefore did not provide occasion or justification for calling in aid the definition of that word in the Act. That definition cannot be used to determine whether the JVA constituted or created a partnership between the appellants and SPSSB. Article 11.7 of the JVA therefore must prevail and be given effect to. The appellants and SPSSB were not a partnership. Therefore there was no dissolution of a partnership and the sum of RM6,400,000 was not capital withdrawn upon the dissolution of a partnership (see para 9).

(2) With regards the issue that the sum of RM6,400,000 was compensation for loss of all rights under the JVA and therefore was not chargeable to tax, the vital test was whether the JVA was related to the whole structure of the appellants' profit-making apparatus. The test looks to the nature of the agreement in relation to the profit-making apparatus of the company (see para 22). In this case, there was no evidence that the JVA related to the whole structure of the profit-making apparatus of the appellants. It was an ordinary contract under which they were to provide certain services in return for an interest in the project.

It was therefore a disposal agreement, not a framework agreement. It was an ordinary commercial contract made in the course of carrying on their business. So whether the JVA was a disposal agreement or a framework agreement, there was no evidence that it related to the whole structure of the appellants' profit-making apparatus (see para 25).

[Bahasa Malaysia summary

Melalui satu perjanjian usahasama bertarikh 4 September 1990 ('PUS'), perayu telah memasuki satu usahasama dengan SPSSB untuk melaksanakan satu projek pembangunan. Akibat beberapa perkara yang tidak dipersetujui antara pihak-pihak, PUS itu dibatalkan melalui sepucuk surat bertarikh 28 Disember 1992 daripada SPSSB kepada perayu. Pada 29 Disember 1992, SPSSB telah membayar perayu RM6,400,000 sebagai pampasan untuk menamatkan PUS itu. SPSSB juga telah membayar perayu sejumlah RM2,100,000 sebagai bayaran balik perbelanjaan dan tanggungan yang dikenakan berkaitan projek itu. Melalui satu notis taksiran bertarikh 24 September 1994 untuk tahun taksiran 1994, responden telah memaklumkan perayu tentang cukai yang ditaksirkan berjumlah RM2,048,000 ke atas jumlah tersebut. Di hadapan Pesuruhjaya Khas Cukai Pendapatan, perayu berhujah bahawa jumlah RM6,400,000 adalah sama ada modal yang dikeluarkan daripada perkongsian yang dibentuk oleh PUS semasa pembubarannya atau pampasan untuk kehilangan semua hak di bawah PUS, dan oleh itu tidak dikenakan cukai. Pesuruhjaya Khas mendapati jumlah RM6,400,000 bukan modal yang dikeluarkan mahupun pampasan untuk kehilangan semua hak di bawah PUS mahupun bayaran perkhidmatan yang diberikan di bawah s 24(1)(b) Akta Cukai Pendapatan 1967 ('Akta tersebut') atau pampasan untuk kehilangan pendapatan

di bawah s 22(2)(b) dan oleh itu boleh dikenakan cukai. Pesuruhjaya Khas juga mendapati bahawa tiada perkongsian wujud antara perayu dan SPSSB dan meskipun perkongsian wujud bayaran RM6,400,000 tidak membentuk pengeluaran modal kerana mana-mana pihak tidak meletakkan modal dalam apa-apa bentuk ke dalam perniagaan usaha sama mereka. Pesuruhjaya Khas mendapati bahawa tiada perkongsian wujud kerana berdasarkan perkara 11.7 PUS pihak-pihak bersetuju yang mereka bukan satu perkongsian. Pesuruhjaya Khas menolak rayuan perayu dan mengesahkan penaksiran responden. Mahkamah Tinggi telah menolak rayuan seterusnya oleh perayu. Perayu oleh itu merayu ke mahkamah ini.

Diputuskan, menolak rayuan dengan kos:

(1) Definisi 'perkongsian' dalam s 2 Akta tersebut tidak terpakai untuk menentukan sama ada urusan antara pihak-pihak adalah suatu perkongsian. Untuk itu, hendaklah lihat kepada undang-undang perkongsian yang mana perayu tidak rujuk kepada. Definisi 'perkongsian' dalam Akta tersebut berniat hanya untuk tafsiran perkataan itu yang digunakan dalam Akta. Dalam menghujahkan bahawa disebabkan jumlah RM6,400,000 adalah modal yang dikeluarkan selepas pembubaran perkongsian ia tidak dikenakan cukai, perayu tidak bergantung pada mana-mana peruntukan Akta, lebih-lebih lagi peruntukan di mana perkataan 'perkongsian' wujud. Hujah tersebut tidak memberikan keadaan atau justifikasi untuk memberi tafsiran kepada perkataan dalam Akta itu. Definisi itu tidak boleh digunakan untuk menentukan sama ada PUS membentuk suatu perkongsian antara perayu dan SPSSB. Perkara 11.7 PUS kekal dan mempunyai kesan. Perayu dan SPSSB bukan perkongsian. Oleh itu tiada pembubaran suatu perkongsian dan jumlah RM6,400,000 bukan modal yang dikeluarkan selepas pembubaran perkongsian (lihat perenggan 9).

(2) Berhubung persoalan bahawa jumlah RM6,400,000 adalah pampasan untuk kehilangan semua hak di bawah PUS dan oleh itu tidak dikenakan cukai, ujian penting adalah sama ada PUS itu berkaitan dengan keseluruhan struktur cara memperoleh keuntungan perayu. Ujian itu melihat sifat perjanjian berkaitan cara memperoleh keuntungan syarikat (lihat perenggan 22). Dalam kes ini, tiada keterangan bahawa PUS berkaitan keseluruhan struktur cara memperoleh keuntungan perayu. Ia adalah satu kontrak biasa di mana mereka memberikan khidmat-khidmat tertentu sebagai balasan untuk kepentingan dalam projek itu. Oleh itu ia suatu perjanjian penyelesaian, bukan perjanjian rangka. Ia adalah kontrak komersial yang dibuat semasa melaksanakan perniagaan mereka. Oleh itu sama ada PUS adalah perjanjian penyelesaian atau perjanjian rangka, tiada keterangan yang ia berkaitan dengan keseluruhan struktur cara memperoleh keuntungan perayu (lihat perenggan 25).]

Notes

For cases on capital versus income, see 10 *Mallal's Digest* (4th Reissue) paras 2121–2123.

Cases referred to

Barr, Crombie & Co Ltd v Commissioners of Inland Revenue [1945] SC 271; 26 TC 406 (refd)

John Mills Productions Ltd (in liquidation) v Mathias (HM Inspector of Taxes) 44 TC 441 (refd)

Sabine v Lookers Ltd (1958) 38 TC 120 (refd)

Van den Berghs, Limited v Clark (HM Inspector of Taxes) 19 TC 390 (refd)

Legislation referred to

Income Tax Act 1967 ss 2, 4(a), 22(2)(b), 24(1)(b)

Appeal from: Case No R2–14–5 of 1998 (High Court (Appeal and Special Powers Division), Kuala Lumpur)

Dr Arjunan Subramaniam (Ozanul Izwan bin Othman with him) (Geraldine Yeoh, Arjunan & Associates) for the appellants.

Abu Tariq Jamaluddin (Zaleha Adam with him) (Legal Officers, Inland Revenue Board) for the respondent.

Abdul Aziz Mohamad JCA (delivering judgment of the court):

[1] By letter dated 29 December 1992, Syarikat Perniagaan Selangor Sdn Bhd ('SPSSB') paid RM6,400,000 to the appellant company. By notice of assessment dated 24 September 1994 for year of assessment 1994, the respondent notified the appellants of tax assessed in the sum of RM2,048,000 on that amount. The Special Commissioners of Income Tax dismissed the appellants' appeal and confirmed the respondent's assessment. The High Court dismissed the appellants' further appeal. The appellants appealed to this court.

[2] The facts, of which some were admitted and some proved before the Special Commissioners, are as follows. By a joint venture agreement dated 4 September 1990 ('the JVA'), which was amended by a supplemental joint venture agreement dated 3 January 1992, the appellants, who had been incorporated on 7 February 1981, entered into a joint venture with SPSSB to carry out a development project involving two lands in Mukim Hulu Kelang, Daerah Gombak, belonging to SPSSB. The project comprised the extension of the leasehold period of the two lands from sixty years to ninety-nine years, the conversion of the lands to residential and commercial use and use for tourist recreational purposes, the construction on the lands of not less than a hundred apartment units, a motel or hotel, a clubhouse and other buildings and facilities, landscaping of the grounds and the provision of infrastructure works. SPSSB's contribution to the project was the two lands, valued at RM5,300,000, and the appellants' contribution was by way of services for obtaining the approvals of the appropriate authorities for the conversion of the use of the two lands, the extension of their leasehold period and their subdivision into parcels as provided in the layout plan. The services of the appellants were valued at RM4.8m and were treated as 48% contribution to the project. It was provided that the appellants had 48% and SPSSB 52% equity in the project. SPSSB were to contribute RM520,000, and the appellants

A RM480,000, as paid-up capital for the project, but no contribution was actually made. There was provision for the appointment of a project management committee comprising representatives from each side. All development cost and other expenses and outgoings for the project, except quit rent, were to be charged to the project. Working capital was to be advanced by the appellants in the first instance. There was
B to be a joint venture bank account. All income was to be the revenue of the project. All profits and losses were to be distributed between the parties according to their respective equity ratios after discharging existing charges over the lands and recouping the development cost. The land premiums and other land processing costs were paid by the appellants from advances made by their directors, and these payments were later reimbursed by SPSSB. All other payments of expenditure were
C made from cash advances by SPSSB.

[3] Owing to disagreements between the parties, the JVA was cancelled by a letter dated 28 December 1992 from SPSSB to the appellants, the contents of which were subsequently agreed to by the appellants. The letter said that SPSSB were prepared
D to pay the appellants RM6,400,000 'as compensation to terminate the JV Agreement between us thereby releasing us and releasing you from the JV Project and JV Agreement with immediate effect'. On 29 December 1992, SPSSB paid the appellants RM6,400,000. SPSSB also paid the appellants a sum of RM2,100,000 as reimbursement of expenses and outgoings incurred in connection with the project.
E On 15 February 1993, a director of the appellants left them to become a director of SPSSB. The appellants were placed under members' voluntary liquidation on 11 November 1993.

[4] Before the Special Commissioners, the appellants contended that the sum of RM6,400,000 was either capital withdrawn from the partnership constituted by the
F JVA upon its dissolution or compensation for the loss of all rights under the JVA, and therefore was not chargeable to tax. The respondent, on the other hand, contended that it was either payment for services rendered or compensation for loss of income as a result of the termination of the contract. If it was payment for services rendered it was chargeable to tax because s 24(1)(b) of the Income Tax Act 1967 ('the Act')
G treats the amount of a debt owing in respect of services rendered as gross income and by s 4(a) income in respect of gains or profits from a business is chargeable to tax. If it was compensation for loss of income as a result of the termination of the contract, it was chargeable to tax as gross income because s 22(2)(b) of the Act includes compensation for loss of income in gross income.

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[5] The Special Commissioners found that the sum was neither capital withdrawn nor compensation for loss of all rights under the JVA but was either payment for services rendered under s 24(1)(b) or compensation for loss of income under s 22(2)(b) and was therefore chargeable to tax. The learned judge on appeal agreed with the Special Commissioners.

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[6] The appellants' contention that the sum of RM6,400,000 that was paid to them was capital withdrawn upon the dissolution of a partnership was founded on the premise that the JVA constituted or created a partnership between the appellants and SPSSB. The appellants' case was that the termination of the JVA brought the

partnership to an end. Therefore the sum of RM6,400,000 paid to the appellants was capital withdrawn from the partnership. The Special Commissioners found that no partnership existed between the appellants and SPSSB and that even if a partnership did exist the payment of RM6,400,000 could not amount to withdrawal of capital because neither party had put in capital in any form into their joint enterprise. The Special Commissioners found that no partnership existed because by art 11.7 of the JVA the parties agreed that they were not a partnership. That article declared as follows:.

> Nothing herein contained shall constitute the parties hereto as partners and it is expressly agreed that the relationship constituted by this agreement is that of a joint venture and not that of a partnership or of a principal-agency relationship. The learned judge agreed with the Special Commissioners

[7] Before us the appellants' counsel argued that whether the appellants and SPSSB were a partnership should, notwithstanding art 11.7, be decided on the basis of the definition of 'partnership' in s 2 of the Act and that by that definition the appellants and SPSSB were a partnership. Learned counsel submitted that if by the Act, through the definition of 'partnership', the appellants and SPSSB were a partnership, they were not entitled to agree between themselves in art 11.7 that they were not a partnership and such an agreement was ineffective to prevent the operation of the definition. Learned counsel said that the Special Commissioners and the learned judge erred in failing to take the definition into consideration.

[8] In paragraph 16 of his written submission, the appellants' counsel says this:

> The wider meaning given to 'partnership' for income tax purposes as opposed to ordinary legal concepts of partnership is of a great importance and the learned Judge failed to appreciate to consider the definition of partnership for income tax purposes in s 2 of the Income Tax Act, 1967.

I particularly quote that paragraph because it is manifest from it that the appellants impliedly concede that the joint enterprise was not a partnership by the 'ordinary legal concepts of partnership' but maintain that it was a partnership solely because it satisfied the definition of 'partnership' in the Act. The definition is as follows:

> 'partnership' means an association of any kind (including joint adventures, syndicates and cases where a party to the association is itself a partnership) between parties who have agreed to combine any of their rights, powers, property, labour or skill for the purpose of carrying on a business and sharing the profits therefrom, but excludes a Hindu joint family although such a family may be a partner in a partnership.

[9] The appellants' counsel in his written submission sets out the features of the arrangement between the appellants and SPSSB that he maintains qualify them as a partnership according to the definition. I am not going to state those features here because in my opinion the definition of 'partnership' in s 2 of the Act is not applicable for determining at large whether an arrangement between parties is a partnership. For that one must turn to the law of partnership which the appellants are not relying on. The definition of 'partnership' in the Act is intended only for the interpretation of that word where it is used in the Act. This is obvious from the

opening words of s 2: 'In this Act, unless the context otherwise requires'. In contending that because the sum of RM6,400,000 was capital withdrawn upon the dissolution of a partnership it was not chargeable to tax, the appellants are not relying on any provision of the Act, let alone a provision in which the word 'partnership' occurs. The contention therefore does not provide occasion or justification for calling in aid the definition of that word in the Act. That definition cannot be used to determine whether the JVA constituted or created a partnership between the appellants and SPSSB. Article 11.7 of the JVA therefore must prevail and be given effect to. The appellants and SPSSB were not a partnership. Therefore there was no dissolution of a partnership and the sum of RM6,400,000 was not capital withdrawn upon the dissolution of a partnership.

[10] The appellants' submission against the further finding of the Special Commissioners and of the judge that the payment of RM6,400,000 could not amount to withdrawal of capital because neither party had injected capital in any form into their joint enterprise, also relies on the definition of 'partnership' in the Act. The appellants argue that because the definition does not impose a condition of injecting cash into a partnership, there could be a withdrawal of capital without any capital in cash having been injected. Since the definition of 'partnership' does not apply to the relationship between the appellants and SPSSB, the appellants' argument that relies on that definition must fail. In any case, that there cannot be withdrawal of capital if there has not been injection of capital is a matter of simple and plain logic that is not affected by whether there is or there is not a requirement for injection of capital. Whether or not there is such a requirement, if no capital is injected there can be no withdrawal of it.

[11] In contending in the alternative that the sum of RM6,400,000 was compensation for loss of all rights under the JVA and therefore was not chargeable to tax, the appellants rely heavily on the case of *Van den Berghs, Limited v Clark (HM Inspector of Taxes)* 19 TC 390. From pp 37 and 39 of the Special Commissioners' Case Stated, it would appear that the appellants cited the case to defeat the respondent's contention that the sum of RM6,400,000 was compensation for loss of income. The case was a dispute concerning the payment of £450,000 by a Dutch company to an English company. The facts of the case, as summarized in the headnote, where the English company is referred to as 'the appellant company', were as follows:

> In 1908, the appellant company, which carried on the business (inter alia) of manufacturing and dealing in margarine and similar products, entered into an agreement with a competing Dutch company by which the two Companies bound themselves for the future to work in friendly alliance and agreed (inter alia) (a) to share the profits of their respective margarine businesses in specified proportions, (b) to bring within the operation of the agreement, if required, any interest in other margarine concerns acquired by companies under their control, (c) not to enter [into] any pooling or price arrangements with third parties inimical to the interests of the two Companies, (d) to set up a joint committee to make arrangements with outside firms as to prices and limitation of areas of supply of margarine; and (e) to promote generally the interests of the two companies in the margarine business. Supplemental agreements made in 1913 and 1920 provided that, with certain modifications, the provisions of the 1908 agreement were to continue in force until 1940.

In the period from 1908 to 1913, payments were made under the agreements by and to the appellant company and were treated for income tax purposes as trading expenses and receipts, respectively, of the years in which they were made. From 1914 to 1919, the two companies were unable to compute their profits owing to the difficulties caused by the war. In 1922, the appellant company arrived at the sum of £449,042 as being the amount due to it by the Dutch company under the agreements. This liability was not admitted by the Dutch company, which claimed that under the agreements there was, on balance, a sum due to it by the appellant company. The matter was referred to arbitration which, however, proved so lengthy and costly that, in 1927, the companies, in contemplation of a merger of interests, entered into negotiations with a view to a settlement of the dispute. The Dutch company desired to cancel the agreements, but the appellant company, which considered that such a course would be to its disadvantage, refused to consent to cancellation unless the Dutch company paid to it, at least, £449,042.

A settlement was finally reached in 1927, whereby, inter alia, (a) all claims and counter-claims under the agreements for the period 1914 to 1927 were withdrawn; and (b) in consideration of the payment by the Dutch company of £450,000 to the appellant company 'as damages', the agreements were determined as at 31 December 1927, and each party released the other party from all claims thereunder. That sum was paid in 1927 and credited in the appellant company's accounts for that year.

The question was whether the amount was a trade receipt, which was taxable, or a capital receipt, which was not taxable. The General Commissioners held that it was a trade receipt, the King's Bench Division that it was a capital receipt, the Court of Appeal that it was an income receipt, and the House of Lords, in 1935, that it was a capital receipt.

[12] In the House of Lords, it was accepted by the respondent that the sum of £450,000 was 'to be taken as having been paid by the Dutch company to the appellants in consideration of the appellants' consenting to the agreements of 1908, 1913 and 1920 being terminated as at 31 December 1927, instead of running their course to 31 December 1940' and that the payment was not to be regarded as having been 'in respect of a balance of profits due to the appellants by the Dutch company for the years 1914 to 1927' (p 431). By consenting in 1927 to the three agreements being terminated, the appellants were giving up something and it was agreed that it was not the balance of profits that had been due since 1914 that the appellants gave up for £450,000. Lord Macmillan said that what the appellants gave up were 'their whole rights under the [three] agreements for thirteen years ahead', that is 1927 to 1940. What were those rights? They were not rights to future profits solely, because Lord Macmillan said that the agreements 'did much more than embody a system of pooling and sharing profits' (p 431). I understand his Lordship to be saying that if the agreements only embodied a system of pooling and sharing profits, then the appellants might be 'merely receiving in one sum down the aggregate of profits which they would otherwise have received over a series of years' and 'the lump sum might be regarded as of the same nature as the ingredients of which it was composed' (p 431), that is, as future profits, but the lump sum could not be regarded as representing future profits because the three agreements did much more than embody a system of pooling and sharing profits.

[13] What, then, was the nature of the three agreements which the appellants agreed to cancel and the rights under which the appellants consequently agreed to

give up, and what did the agreements do? As to the nature of the three agreements, Lord Macmillan began in the last paragraph at p 431 by emphasizing what they were not, that is, they:

> were not ordinary commercial contracts made in the course of carrying on their trade; they were not contracts for the disposal of their products or for the engagement of agents or other employees necessary for the conduct of their business; nor were they merely agreements as to how their trading profits when earned should be distributed as between the contracting parties.

Then he went on to state as follows:

> On the contrary, the cancelled agreements related to the whole structure of the appellants' profit-making apparatus. They regulated the appellants' activities, defined what they might and what they might not do, and affected the whole conduct of their business.

And towards the end of his speech at p 432 he added:

> The agreements formed the fixed framework within which [the appellants'] circulating capital operated; they were not incidental to the working of their profit-making machine but were essential parts of the mechanism itself. They provided the means of making profits, but they themselves did not yield profits. The profits of the appellants arose from manufacturing and dealing in margarine.

[14] With that perception of what the three agreements did, Lord Macmillan stated the following conclusion, which begins at the end of p 431:

> I have difficulty in seeing how … money received for the cancellation of … so fundamental an organisation of a trader's activities can be regarded as … an income receipt.

He said at p 432 that what the appellants surrendered (by the cancellation of the three agreements which cancelled 'so fundamental an organisation' of the appellants' activities) was an asset, adding:

> In my opinion that asset, the congeries of rights which the appellants enjoyed under the agreements and which for a price they surrendered, was a capital asset.

[15] In *John Mills Productions Ltd (in liquidation) v Mathias (HM Inspector of Taxes)* 44 TC 441, Ungoed-Thomas J, in a judgment given on 27 July 1964, said at p 449C that it was in the speech of Lord Macmillan in *Van den Berghs* that originated the case law on one of the questions to be decided by him in *John Mills*, which was a question of a kind to which belongs the question that lies at the root of the appellants' alternative contention in the present case, namely, whether the sum of RM6,400,000 received by them for cancellation of the JVA was capital and therefore was not liable to income tax. It may be understood from p 449B, G-H of *John Mills* that for the sum in the present case to be capital the vital test to be satisfied is that the agreement that was cancelled, namely the JVA, must be one that was 'related to the whole structure of the appellants' profit-making apparatus'. Those are the words of Lord Macmillan in the last paragraph on p 431 of *Van den Berghs* quoted earlier. It appears to be considered by the cases after *Van den Berghs*, including *John Mills*, that the payment in *Van den Berghs* was considered by the House of Lords as capital because

the agreements as a result of the cancellation of which the appellants in that case received the sum 'related to the whole structure of the appellants' profit-making apparatus'. So the vital question for the alternative contention of the appellants in this case is whether the JVA related to the whole structure of the appellants' profit-making apparatus. If it did, and only if it did, the payment was capital. Otherwise, it was income. It is therefore necessary to understand what is meant by an agreement being 'related to the whole structure of the appellants' profit-making apparatus', and for that it is necessary to examine *Van den Berghs* further and also *John Mills* and the cases considered by Ungoed-Thomas J. But for a start I should say at once that the wording of the test clearly indicates that the agreement in question is not the taxpayer's profit-making apparatus nor does it create the profit-making apparatus. The profit-making apparatus is an organization or set-up that a taxpayer must necessarily and inevitably already have that makes profits if he is in the business of making profits.

[16] In *Van den Berghs*, the English company and the Dutch company were, in the words of Lord Macmillan at p 425, 'keenest competitors' of each other. If they continued to be in keen competition, one might lose out. Therefore it would be better to stop competing and be in friendly alliance under an arrangement in which each party would retain the freedom to carry on its business and earn as much profit as possible from it but subject to certain controls and a complicated scheme of pooling and distribution of the profits that each party would be making. The controls were necessary so that one party would not do things that would be inimical to the profit-making capability of the other party. The controls on one party were valuable to the other party and constituted rights against the former party. The elaborate formula for pooling and sharing of profits was, I imagine, to ensure that, in any case, no matter how much profits each party made and what methods it used to make them, it would not necessarily enjoy them completely but some of them must be enjoyed by the other party. Like the controls, the arrangement about profits was also to ensure that one party would not get rich at the expense of the other. That is, putting it simply and maybe inadequately and possessing of but little knowledge about such things, what I understand to be the philosophy behind the agreements in *Van den Berghs*. Such an understanding of the philosophy assists me towards an understanding of what Lord Macmillan meant when he said that the agreements were more than a system of pooling and sharing profits but gave the appellant English company a 'congeries of rights' that constituted a capital asset, and also when he said that the agreements were a means of making profits although they themselves did not yield profits.

[17] It will be recalled that Lord Macmillan said that the three agreements in *Van den Berghs* were not contracts for the disposal of the appellants' products and that when saying that they related to the whole structure of the appellants' profit-making apparatus he explained that 'They regulated the appellants' activities, defined what they might and might not do, and affected the whole conduct of their business'. Accordingly in *John Mills*, Ungoed-Thomas J characterized the agreements in *Van den Berghs* as a framework agreement (p 453B), an agreement that merely laid down trading conditions (p 449H), as opposed to a disposal agreement. They were a framework agreement because, to my mind, they provided what may be likened to

a constitutional framework subject to which the English company's, as also the Dutch company's, profit-making apparatus was to operate. As I indicated before, they did not constitute or create the English company's profit-making apparatus. They merely related to the whole structure of it.

[18] Later, the *Van den Berghs* test came to be applied also to disposal agreements. In *John Mills*, after considering several cases decided after *Van den Berghs*, Ungoed-Thomas J said this at p 453B:

> Thus these cases establish, to my mind, (1) that the *Van den Berghs* test applies both to what was conveniently referred to in argument as a framework agreement, as in *Van den Berghs*' case, and as a disposal agreement, as in the *Barr, Crombie* case; and (2) that in all the cases so far decided the need for the agreement to relate to the structure of the profit-making apparatus has been sufficiently satisfied by its relating to the commercial organisation of the company, and that it is in that sense that Lord Macmillan's words have been understood and applied.

> The disposal agreement that is brought to an end must relate to the whole structure of the profit-making apparatus of the taxpayer-company and that requirement is satisfied if the agreement relates to the commercial organisation of the company. Although the passage says 'the structure', and not 'the whole structure', of the profit-making apparatus, Ungoed-Thomas J must have meant 'the whole structure' because he had earlier said, at p 449G-N, 'the vital test is whether the agreement is 'related to the whole structure of the appellants' profit-making apparatus.

[19] Of the cases considered by Ungoed-Thomas J in *John Mills*, I propose to mention only two as examples of situations after *Van den Berghs* that would invite the conclusion that a disposal agreement that is brought to an end relates to the whole structure of the profit-making apparatus of the taxpayer-company.

[20] One case is the case mentioned in the passage just quoted, namely, *Barr, Crombie & Co Ltd v Commissioners of Inland Revenue* [1945] SC 271; 26 TC 406. This was examined at p 450 of *John Mills*. I quote the facts at p 450A-B as stated by Ungoed-Thomas J: 'The company carried on business as shipowners and shipping managers and agents, and it had an agreement to manage the affairs of another company on terms which included a provision that, on the liquidation of the other company, a sum should be paid to it in respect of the period from liquidation to the date of the expiry of the agreement. 88 per cent of the company's income was obtained under this agreement, and on the liquidation of the other company it lost almost its entire business.' For further facts I quote Lord Normand at p 450C, speaking in *Barr, Crombie*: 'When the agreement was surrendered or abandoned practically nothing remained of the company's business. It was forced to reduce its staff and to transfer into other premises, and it really started a new trading life. Its trading existence as practised up to that time had ceased with the liquidation of the shipping company.' It was a case of an agency agreement for the disposal of a company's services. It was held that the payment that the company received under the agreement consequent upon the liquidation of the other company was a capital payment. Ungoed-Thomas J remarked as follows at p 450H-I: 'Thus an agreement for the disposal of services is capable of satisfying the *Van den Berghs*' test, but it appears that in the *Barr, Crombie* case the business organisation of the company was

constructed to meet the requirements of this agreement, so that the agreement could not be cancelled without damaging the whole structure of that profit-making apparatus constructed to earn money in accordance with the provisions of the agreement'. The case gives a good idea of when it can be said that a disposal agreement is 'related to the whole structure of [a company's] profit-making apparatus'. The outstanding feature of the case is that the business organization of the company was constructed to meet the requirements of the agreement. It was solely because of the agency agreement that the business organization of the company was constructed as it was.

[21] The other case is *Sabine v Lookers Ltd* (1958) 38 TC 120, Ungoed-Thomas J gave the following facts at p 451G of *John Mills*: '… the whole of a motor distributor company's trade was geared to the display, sale, service and repair of the Austin Motor Co's products, and the company had installed fixtures and equipment designed for this purpose. Compensation paid by Austin's to the distributors for variation of a continuity clause in the agreement between them was held to be a capital receipt.' The nature of the agreement is stated as follows at pp 451I to 452B, in the words of Jenkins LJ in *Sabine*: 'The agreement did not merely lay down terms in regard to the purchase and sale of vehicles but in effect laid down the conditions under which Lookers had to trade and earn their profits. Thus it in effect limited their trade to Austin vehicles; it provided that Lookers had to set up a particular sales organisation; it limited the prices at which sales could be made; and it required them to service and repair Austin vehicles. The distributorship … governed Lookers' whole trade and was not merely one of several contracts or engagements.' Ungoed-Thomas J remarked as follows at p 452B-C: 'The treatment of compensation for cancellation of an agreement which satisfied the *Van den Berghs* test was thus extended in this case to compensation for variation of such an agreement. But again in this case, as in the *Barr, Crombie* case, … it would appear that the agreement was held to satisfy the *Van den Berghs* test because it 'governed Lookers' whole trade', including thus, in the words … from other cases, their 'normal commercial organisation' and 'the whole structure of the profit-making apparatus'.' The *Sabine* case also gives a good idea of when an agreement can be said to be 'related to the whole structure of [a company's] profit-making apparatus'. The outstanding feature of the case is that the whole trade of the company was geared to the distributorship agreement and that the agreement governed the company's whole trade.

[22] As I said, on the alternative contention of the appellants, which is that the sum of RM6,400,000 was compensation for the loss of all rights under the JVA, the Special Commissioners found against them, and the judge agreed with the Special Commissioners. The thinking of the learned judge is revealed on p 12 of his grounds of judgment. He stated the correct test, the test that was laid down in *Van den Berghs* and highlighted in *John Mills*. He said that the vital test is whether the JVA was related to the whole structure of the appellants' profit-making apparatus. But he did not say whether the test was satisfied. He seems to have failed to appreciate the true meaning of the test. This is apparent from what he said about this case. He said that 'mere surrendering of rights does not make the payment of the RM6,400,000 a capital receipt without there being a destruction of the profit-making apparatus of the appellant'. Then after stating the test he said: 'There was no evidence adduced that

after the termination of the joint venture agreement the appellant was completely unable to carry out its other business objectives.' From those statements, it is clear that he understood the test to mean that the termination or cancellation of the agreement must result in the destruction of the profit-making apparatus of the taxpayer-company. But that is not the test. The test looks to the nature of the agreement in relation to the profit-making apparatus of the company. It must be an agreement that can be said to be related to the whole structure of the profit-making apparatus of the company. It is true that sometimes one needs to see how the termination or cancellation of the agreement affects the structure of the profit-making apparatus in order to be able to say whether or not by its nature it is an agreement that relates to the whole structure of the profit-making apparatus. But the test certainly does not look primarily to the consequences on the profit-making apparatus of the cancellation or termination of the agreement. One does not look to see whether the destruction of the agreement destroys the profit-making apparatus. In *Van den Berghs Ltd*, for example, the profit-making apparatus of the appellant English company did not suffer from the termination of the three agreements.

[23] The Special Commissioners likewise misunderstood the test. At p 29 of the Case Stated they said: '… the principle in *Van den Berghs Ltd* … does not support this contention. The termination of the JVA did not destroy 'the structure of the appellant's profit making apparatus' … The appellant was still free to carry on its other businesses'.

[24] The appellants' counsel, while saying — and correctly too — that the Special Commissioners and the judge erred in their decision as regards the test, also misunderstands the test. He argues that the business under the JVA was the appellants' only business and that the cancellation of the JVA brought the business to a close. He reveals his understanding of the test in these words in paragraph 30 of his written submission: 'That is what is meant that 'structure' came to an end; their business under their JVA came to an end.' He uses the word 'structure' as synonymous with 'business'. This can be seen in paragraph 35 where he says: '… the JVA … was vital to the appellants' business and any cancellation would lead to the structure being destroyed. The cancellation led to close of its only business at the point in time'. The appellants' counsel has erred in several respects. First, the test involves 'structure of … profit-making apparatus', not just 'structure'. Second, 'profit-making structure' is not business. Third, and most important, the test does not require that the business of the taxpayer-company be destroyed or brought to an end. The test is whether the agreement that is cancelled or terminated 'is related to the whole structure of the company's profit-making apparatus' which, as I said, is a test of the nature and effect of the agreement and not a test of the consequences of its cancellation or termination. If the agreement is related to the whole structure of the profit-making apparatus of the company, then money that is paid on account of the cancellation of it is capital, and if the agreement is not so related then the money is income, and that is so irrespective of whether the cancellation or termination of the agreement destroys the company's business.

[25] In this case there was no evidence that the JVA related to the whole structure of the profit-making apparatus of the appellants. The appellants were incorporated in

1981. It is not clear what their business was because although the Special Commissioners found that it was the business of providing project management services, a director of the appellants explained in an affidavit in the High Court that 'It was simply my personal office management services provided by me, on behalf of [the appellants] to my husband's firm'. In 1987, they obtained a licence to conduct real estate business. In 1990, they entered into the JVA. They therefore were not incorporated to implement the JVA. There is no evidence how the JVA affected the structure of their profit-making apparatus or whether or how their profit-making apparatus was geared to meet the needs of the JVA. Neither did the JVA regulate their activities. It was an ordinary contract under which they were to provide certain services in return for an interest in the project. Looking at it from the standpoint of what the appellants had to do under it, it was a contract for the provision of services. It was therefore a disposal agreement, not a framework agreement. It was an ordinary commercial contract made in the course of carrying on their business. The appellants were not restrained by the JVA from providing their services to other people whether through another JVA or otherwise. It did not regulate the appellants' activities in that way or any other way. The joint committee that was formed under the JVA was merely to ensure its proper and fair implementation. The committee did not form part of the structure of the appellants' profit-making apparatus. So whether the JVA was a disposal agreement or a framework agreement, there was no evidence that it related to the whole structure of the appellants' profit-making apparatus.

[26] The appellants have therefore failed to show that the Special Commissioners were in error in finding, contrary to the appellants' contention, that the sum of RM6,400,000 was neither capital withdrawn from a partnership nor compensation for loss of all rights under the JVA.

[27] As I said earlier, the respondent's contention was that the payment was either for services rendered or as compensation for loss of income, and the Special Commissioners so found. In paragraph 3.4 of his written submission in this appeal the respondent contends that the payment was for services rendered. The Special Commissioners found that by reason of the services that the appellants duly performed under the JVA, SPSSB's lands, which remained with SPSSB after the cancellation of the JVA, had increased in value from RM5,300,000 to about RM15,000,000. In arguing in this appeal that the Special Commissioners erred in their findings the appellants' counsel says, firstly, that according to the agreed facts the services were performed as part of the appellants' contribution to the joint venture and therefore were rendered to the joint venture and not to SPSSB. But what was the joint venture? It constituted or represented the interests of the appellants and SPSSB. The services rendered were, while the joint venture lasted, a contribution to their common interest. But once the joint venture ended, the lands remained with SPSSB and the appellants ceased to have any interest in them. The services rendered to the joint interest had benefited SPSSB in that they increased the value of their lands. With the termination of the joint venture, the services that had increased the value of SPSSB's lands were as good as having been rendered to SPSSB. And with the termination of the joint venture, if there was to be any payment to be made to the appellants, there was only SPSSB to make the payment. So it makes no difference to

A the fact that the payment by SPSSB was for services rendered that the services are seen, too narrowly and artificially I must say, as rendered to the joint venture and not to SPSSB.

[28] Secondly, in paragraph 39(a)(v) of his written submission the appellants' B counsel says that if the payment was for services rendered the appellants must be an independent contractor whereas the facts proved do not show that they were. It is not clear in what sense the appellants regard themselves as not being an independent contractor, but whether or not they were an independent contractor in the sense intended, the fact was that under the JVA the appellants contracted with SPSSB to perform services, and they did perform them. The same may be said of the suggestion C in paragraph 36 of the written submission that for the payment to be for services rendered the JVA must be an agency agreement, which it was not.

[29] The appellants have failed to show that the Special Commissioners erred in finding that the payment was for services rendered.

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[30] The appellants argue that even if the sum of RM6,400,000 is taxable, the correct year of assessment should be 1992 and not 1994 because the work for which the payment was made was completed in February 1991. This question was not before the Special Commissioners and neither is it raised in the memorandum of E appeal. It therefore ought not to be considered.

[31] My learned brothers, Mokhtar Sidin JCA and Raus Sharif J to whom the draft of this judgment has been furnished, have expressed their concurrence with my decision and with the reasons for it that I have set out. The appeal is dismissed with costs. The deposit is to be paid to the respondent in part payment of costs.

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Appeal dismissed with costs.

Reported by Loo Lai Mee

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